No. 12,054

IN THE

United States Court of Appeals

For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY
(a corporation),
Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORATION
(a corporation),
Appellee.

BRIEF FOR APPELLEE.

CLAUDE N. ROSENBERG,
TADINI BACIGALUPI,
KENNETH RAY,
300 Montgomery Street, San Francisco 4, California,
Attorneys for Appellee.

BACIGALUPI, ELKUS & SALINGER,
300 Montgomery Street, San Francisco 4, California,
Of Counsel.

Subject Index

Table of Authorities Cited

Codes

Texts

Rules

No. 12,054

IN THE

United States Court of Appeals

For the Ninth Circuit

PACIFIC PORTLAND CEMENT COMPANY
(a corporation),
Appellant,

vs.

WESTVACO CHLORINE PRODUCTS CORPORATION
(a corporation),
Appellee.

BRIEF FOR APPELLEE.

STATEMENT AS TO JURISDICTION.

Appellee concurs in the jurisdictional statement contained in appellant's brief.

STATEMENT OF THE CASE.

Appellant correctly observes that the principal dispute involved in this appeal concerns paragraph (6) of the contract.[1] Appellant contended in the trial court, as it does here, that the language means, and was intended to mean, that in determining the cost of production of gypsum only those expenses that are directly charged and precisely ascertainable should

[1] Appellant's Brief, page 4.

be included, to the exclusion of overhead expense and other indirect charges which, because of their very nature, must be and ordinarily are allocated, on some rational basis, among the various products produced in a single plant.[2] Appellant sought to prove that gypsum, as produced by appellee, is a by-product and that in determining the cost to produce a by-product, it is improper accounting to include overhead expense and indirect charges. Appellee contended to the contrary—that "cost of production" as used in the contract was intended to mean all costs that are usually included in determining the cost of a manufactured product, including overhead expense and indirect charges; and that regardless of whether gypsum be considered as a by-product or a co-product, good accounting practice requires the inclusion of the latter items.

Substantially all of the evidence adduced at the trial related to these conflicting contentions and the concomitant question whether, as alleged by appellant,[3] cost of production had been incorrectly determined by appellee from time to time, as the basis for the price increases established by appellee pursuant to paragraph (6) of the contract. Appellant also alleged that the payments made by it to appellee in the past exceeded the amount properly chargeable by appellee

---

[2]A typical example of allocated charges was given by appellant's vice-president in explaining how appellant, in its own plant, allocates the salary of the plant superintendent among the 4 products produced in the plant, using direct labor as the allocation factor, exactly as does appellee. (R. 315-316.)

[3]Par. 9 of Complaint, R. 5.

under the contract in the aggregate sum of $9,405.93 for which sum appellant prayed judgment.

After a protracted trial during which the court heard 15 witnesses, including the two persons who negotiated the contract, and viewed 32 exhibits, the court found, on conflicting evidence, among other things, as follows:

1. That it was unnecessary to find whether or not the gypsum produced by appellee is a by-product, because "in determining the cost of production of a by-product which requires an independent physical plant, and independent labor to be performed upon it, in order to convert it into a marketable product, as does the gypsum produced by appellee at its Newark, California, plant, good accounting practice requires the inclusion of 'overhead expense' and 'indirect charges'." (Finding 2, R. 48.) Referring to appellant's contention that these charges should be excluded, the court stated in its opinion as follows:

> "This position is not supported by the evidence, which shows that accepted accounting practice may charge to a by-product a proportionate share of indirect and overhead as well as the direct costs." (R. 72.)

2. That the cost of producing gypsum as determined by appellee from time to time, and the resultant increases in price so determined by appellee, have been in accordance with the terms and provisions of the contract. (Finding 8, R. 50-51.)

3. That the terms "cost of production" and "cost of manufacture" as used in paragraph (6) of the

contract, are synonymous, and that such terms "are not and were not intended by the contracting parties, or either of them, at the time of the execution of said contract, to be limited or restricted to 'actual' or 'direct' costs"; that such terms "include and were intended by the contracting parties to include overhead expense and indirect charges which cannot be directly charged to or against each of the various products produced by defendant at its Newark, California, plant, and which must, therefore, be allocated to or apportioned among such products on some reasonable basis; that in determining its cost of production of gypsum from time to time, defendant has fairly and reasonably allocated overhead expense and indirect charges thereto." (Finding 9, R. 51.) In connection with this finding, the court stated in its opinion that "it seems clear to the court that when the parties used the term 'cost of production' they intended to include all costs that might be shown by accepted accounting practice." (R. 72.)

4. That the specific costs, as determined by appellee for the three periods in question, and the three resulting price increases, were established by appellee in accordance with the terms and provisions of the contract. (Findings 10, 11 and 12, R. 51-55.)

5. That it is untrue that the payments for gypsum made by appellant to appellee during the period from September 4, 1946, to and including January 31, 1947, exceeded the amount properly chargeable by appellee under the contract by the sum of $9,405.93, or any other sum or at all. (Findings 11 and 12, R. 53, 55.)

In paragraph 2 of the Specification of Errors, appellant asserts that the court erred "in failing to find" that for the purpose of establishing, under the contract, the actual advance in appellee's cost of manufacture and the resultant increase in price, it is improper to include overhead expense, indirect charges, new products research, expenses of a general and administrative nature, and depreciation on a "straight line" basis; and that the court likewise erred in "failing to find" that inconsistent accounting methods were improperly employed by appellee in two cost periods in determining the costs of sulphuric acid, indirect shipping expense, and air compressor.

By virtue of the findings above mentioned, the trial court determined that appellee had properly charged and included the items which appellant now disputes, and it approved the accounting methods that appellant questions. We conceive, therefore, that the errors specified by appellant in said paragraph 2, constitute an attack upon the sufficiency of the evidence to support these findings, notwithstanding that the alleged errors are phrased as a "failure to find" in accordance with appellant's contentions. We mention this for the reason that in its brief appellant argues, in effect, that the evidence preponderates in favor of appellant's contentions, or that the evidence introduced by appellant was more convincing than that presented by appellee. That approach would be proper in a brief addressed to the trial court. It serves no purpose in a brief on appeal, where all presumptions are in favor of the correctness of findings based upon

conflicting evidence. What appellant asks is that this court try the case *de novo* on the record, a practice which was condemned by this court in *Goldstein v. Polakof,* 135 F. (2d) 45. Furthermore, appellant has disregarded almost entirely a mass of substantial evidence which abundantly supports the findings, and to which we will refer in argument for the purpose of showing that the findings should be sustained.

ARGUMENT.

I.

INTRODUCTORY STATEMENT.

As stated by appellant, the correct determination of the issues involved upon this appeal are of vital importance to the litigants. The importance to appellee is greater than to appellant. Under the terms of the contract, appellant may restrict its purchases of gypsum to 20,000 tons in any year, if it so chooses, or it may cancel the agreement at any time on one year's notice, and thereby entirely relieve itself of further obligation thereunder. (Pars. 2 and 3, R. 9-10.) Appellee has no such right. Except for the 4,000 tons per year mentioned in paragraph (1) of the contract, it can be required to sell its entire gypsum production to appellant until January 31, 1962, at the price fixed under the contract. (Par. 2, R. 9.) Should the judgment in this case prevent appellee from including in its cost of production any item properly includable therein, the effect upon appellee during the

remaining term of the agreement would be extremely serious.[4]

At the outset of its argument, appellant takes occasion to direct the attention of the court to the fact that appellee's cost of production of gypsum, including both direct and indirect charges, increased only 45¢ per ton from the year 1938 to the period ending June 30, 1946, but that appellee is claiming an increase of $1.56 per ton over the original contract price. (Appellant's Brief, p. 16.) It is pointed out that appellee's profit under the $4.36 price is substantially greater percentage-wise than it was in 1938. From this it is argued that the men who negotiated the contract could not have intended "such results" in adopting the contractual language. This argument is totally without merit. The basic issue in this case was whether the term "cost of production" as used in paragraph (6) of the contract was intended to mean all costs, including overhead expense and indirect charges, or was restricted to direct costs. Whether the contracting parties anticipated or realized that the aggregate price increases under the contract at a particular time might exceed the aggregate increase in cost of production during the elapsed term of the contract is entirely irrelevant to this basic issue. The relation between appellee's profits in 1938 with those at the

[4]Appellant argued in the trial court that appellee had "something better than an escape clause" in that it could discontinue production of gypsum at any time. (R. 1276.) We submit that the privilege of discontinuing production of a product falls far short of the right to cancel a sales contract and thereafter sell the product at such price and to whoever the manufacturer desires.

present or at any other time is likewise of no significance.

Paragraph (6) of the contract is somewhat unique in that the escalator provisions thereof are not related to the cost of production in 1938 or in any other specific base period. This probably may be explained by the fact that the contract was entered into before the plant was constructed and hence before cost figures on production of gypsum were available. (R. 747.) Under the express language of paragraph (6) appellee is entitled to an increase in price if its cost of production in any 12-month period exceeds by 5% the cost in the preceding 12 months. Hence, the comparison of the increase in cost of production between 1938 and 1946 with the aggregate price increase under the contract during that period, is utterly meaningless. As dips and rises in production costs occur over the 25 year term of the contract, the price to which appellee is entitled in accordance with the provisions thereof may very well exceed the original contract price of $2.80 by more than the amount by which the current cost of production exceeds the initial cost of production. That is a potentiality that is implicit in the fact that paragraph (6) provides for price increases premised upon the relation of cost in any successive 12-month periods, rather than on the cost at a particular time as related to the cost at some fixed base period. This is not the consequence of the accounting methods that are employed. The identical results could occur regardless of whether cost of pro-

duction were construed to mean only direct costs, as advocated by appellant, or to include also overhead expense and indirect charges, as contended by appellee and found by the trial court.

The use of the year 1938 for comparative purposes is particularly odious because that year would not constitute a fair criterion of initial cost in any event. Only 10,948 tons of gypsum were produced in 1938. Naturally, with small production unit cost was high, amounting to $2.67 per ton. (Pltf's. Ex. 18, R. 565.) This left appellee a bare margin of 13¢ per ton, less deductions taken by appellant under paragraph (5) of the contract. In the 12-month period ending June 30, 1940, the plant first reached substantial production, the output being 27,685 tons, at a unit cost of $1.66 per ton. (Pltf's. Ex. 18, R. 565.) If comparative figures were material, this is the first year that reasonably could be considered as representative of initial cost of production. Comparing this cost of $1.66 per ton with the cost of $3.12 per ton in the 1945-1946 period, shows an increase of $1.46 per ton. This compares very closely to the difference of $1.56 per ton between the price of $4.36 and the original contract price of $2.80. Appellee's profit was $1.14 per ton under the $2.80 price in 1940, and was $1.24 per ton when the $4.36 price became effective.

Although it is no more relevant than is the matter of appellant's profits, it is interesting to note that from 1940 to September 1946, appellant resold to Permanente at $4.98 per ton the gypsum that it

purchased from appellee at $2.80 and $2.98, realizing a profit of $2.18 per ton until October 1941 and $2.00 per ton thereafter until September 1946. From the latter date until some time before trial, appellant received $6.78 per ton or a profit of $2.42 per ton over the price of $4.36 which it paid to appellee. (R. 64, 385-386, 588.) Appellant now seeks an additional windfall of 84¢ per ton on all gypsum purchased under the contract since September 1946. (R. 385.) There is no evidence of the resale price obtained by appellant since cancellation of its contract with Permanente.

It is obviously not true that the inclusion of overhead expense and indirect charges in cost of production has brought about results that compel the conclusion that the contracting parties intended only direct costs to be included. The circumstances to which appellant referred have no bearing on that subject. What the effect of the escalator clause has been in the past or what it might be in the future is of no aid whatever in ascertaining the intention of the contracting parties as to the accounting procedure to be employed in determining "cost of production." The fact that indirect costs in the past have increased more than have direct costs is immaterial and purely coincidental. It is futile to relate price increases to cost of production in 1938, since that is not the basis specified in the contract. The intent of the contracting parties is not to be determined by hindsight. It is to be derived from

the language of the document and the circumstances attending its execution, as was done by the trial court. (R. 68.)

A similar point of equal speciousness is made by appellant, however timidly, at page 34 of its brief. Appellant there suggests the possibility that the use of the language "not to exceed the actual advance in cost of manufacture" indicates that the aggregate price increase since the first year cannot exceed the net increase in all asserted costs since that time. This interpretation was not asserted by appellant in the trial court. It is merely stated without argument in the brief and obviously is an afterthought that is not urged with any seriousness.

As just pointed out, price increases under the contract are not related to "cost of production" in the "first year" or in any other fixed base period. There is no language in the contract from which the suggested meaning could be derived. Appellant's own interpretation consistently has been and still is otherwise.

Over the elapsed term of the contract, appellee has claimed three price increases aggregating $1.56, bringing the price to $4.36 per ton. The first increase of 18¢ resulted from increased cost of production in the 12-month period ending June 30, 1941, above the cost in the preceding 12 months. (R. 3.) The second increase of 78¢ resulted from increased cost of production in the year 1943 over 1942. (R. 3-4.) The third increase of 60¢ resulted from increased cost of pro-

duction in the 12-month period ending June 30, 1946, above the cost in the preceding 12 months. (R. 4-5; Appellant's Brief, pp. 5-6.) Appellant disputes the overhead expense and indirect charges included in these cost figures but admits that appellee is entitled to an additional 72¢ per ton over the original contract price of $2.80, or a price of $3.52, by reason of increases in direct costs during the three comparative periods above mentioned. (Appellant's Brief, p. 6.) Yet, in each of the six years involved in these three periods, the direct costs were less than they were in 1938. (R. 565.) Thus appellant has itself effectively refuted its own passing suggestion that the language of the contract might mean that the aggregate price increases since 1938 "cannot exceed the net increase in all asserted costs" since that time.

II.

THE FINDINGS OF THE TRIAL COURT ARE PRESUMED TO BE CORRECT AND ARE TO BE ACCEPTED ON APPEAL UNLESS SHOWN BY APPELLANT TO BE CLEARLY WRONG.

Speaking of the interpretation of Rule 52(a) of the Rules of Civil Procedure by the Supreme Court in *United States v. U. S. Gypsum Co.,* 333 U.S. 364, this court very recently stated in *Grace Bros. Inc. v. Commissioner of Internal Revenue,* (No. 11976) '49-5 CCH Federal Tax Service, par. 9181, as follows:

> "This interpretation is not a new departure. It merely stresses, as courts of appeal (including this court), have done before, that findings are

> to be given the effect which they formerly had in equity."

The rule in equity long has been that where a trial court, as in this case, has made a finding upon conflicting evidence, the finding is presumptively correct, and unless some obvious error of law has intervened or some serious mistake of fact has been made, the finding must be permitted to stand. (*Lincoln Nat. Life Ins. Co. v. Mathisen,* (9 Cir. 1945), 150 Fed. (2d) 292; *Warren v. Keep,* 155 U.S. 265.)

In this circuit the principle was stated in *Columbia Nat. Life Ins. Co. v. Quandt & Sons,* 154 Fed. (2d) 1006, as follows:

> "Where there is a conffict in the evidence, this court must keep in mind that the trial judge who hears and sees the witnesses has a better opportunity to appraise their credibility and judge the weight to be attached to their testimony. * * * It is the rule that the findings of the trial court are to be accepted on appeal unless clearly wrong."

Application of this principle requires that the findings in the instant case be sustained.

III.

THE TRIAL COURT PROPERLY FOUND THAT THE TERMS "COST OF PRODUCTION" AND "COST OF MANUFACTURE" AS USED IN PARAGRAPH (6) OF THE CONTRACT ARE NOT AND WERE NOT INTENDED BY THE CONTRACTING PARTIES TO BE LIMITED OR RESTRICTED TO "DIRECT" COSTS, AND THAT SUCH TERMS INCLUDE AND WERE INTENDED TO INCLUDE OVERHEAD EXPENSE AND INDIRECT CHARGES.[5]

A. The evidence of the circumstances attending the execution of the contract supports the finding.

The first unit of appellee's plant at Newark, California, was constructed in 1930, being a plant from which bromine was extracted from bittern, as the sole product of the plant. (R. 743.) In 1935 a small "pilot plant" was constructed to experiment in the production of magnesium and gypsum from bittern. (R. 744-745.) Experiments continued for two years during which time numerous tests were made to determine the salability of gypsum, and samples were submitted to appellant. (R. 746.) It was not until appellant approved the product that negotiations for the contract began. (R. 747.)

These negotiations were carried on between Mr. Colton on behalf of appellant and Mr. Barrows on behalf of California Chemical Company, the predecessor of appellee. The negotiations commenced some time around the middle of 1936. (R. 756, 1097.) This was approximately seven or eight months before the contract was executed on January 29, 1937. (R. 8.) After some preliminary conversations, under date of June 5, 1936, Mr. Barrows, at the request of Mr. Colton, wrote a letter "roughly outlining the terms

[5]R. 51.

under which he would contract for the sale of the gypsum." (Pltf's Ex. 5, R. 164-167, 758, 760.) This letter contemplated a contract under which California Chemical Company would purchase oyster shell from appellant and appellant would purchase lime and gypsum from California Chemical Company, the latter items to be produced in a plant which California Chemical Company expected to construct at Newark, California.[6] In paragraph 11 of the letter it was stated that the contract would contain certain price protection clauses "to guard against increases in labor, fuel and supplies, some moderate minimum payment to keep the contract alive in depression or competitive siege, privilege of cancellation by us (California) on 15 months' written notice, together with many other features not intended for preliminary contemplation."[7] Mr. Barrows testified that what he had in mind at that time was that if the cost of production got out of hand, California Chemical Company could cancel the contract. (R. 797.)

Under date of September 18, 1936, Mr. Barrows transmitted to Mr. Colton a draft of proposed agreement which again contemplated the sale of oyster shell by appellant to California Chemical, and the sale of lime and gypsum by California Chemical to appellant. (R. 761; Deft's Ex. H, R. 881-893.) This draft of agreement, as did the letter of June 5, 1936, likewise reserved a cancellation privilege to California Chemi-

[6]The contract as finally executed provided for only the sale of gypsum by appellee to appellant—it does not involve the sale of lime or oyster shell.

[7]Throughout this brief all emphasis is added unless otherwise indicated.

cal Company, exercisable upon one year's notice. (Par. 12, R. 891-892.) Paragraph (6) of the proposed agreement provided for increases in the prices of lime and gypsum in the event of an increase of 5% or more in cost "above the first year's average direct cost."[8] (R. 888-889.) Mr. Barrows testified that following the letter of September 18, 1936, he had further conversations with Mr. Colton in the course of which the latter objected to the cancellation clause. (R. 762.) Although Mr. Barrows had originally suggested an escalator clause based only upon increases in direct costs, at which time he had in mind that if costs got out of hand California Chemical could cancel the contract, the fact that Mr. Colton would not grant the cancellation privilege precipitated further discussion of costs for the better protection of the seller. (R. 792.) The bone of contention between Mr. Barrows and Mr. Colton was how to arrive at "cost of production." (R. 876.) Finally in December 1936, in conversation with Mr. Colton, Mr. Barrows insisted that he would not be restricted merely to the items previously mentioned as "there are other items that go to make up cost of production." Mr. Barrows mentioned a number of items, but Mr. Colton thought that they could not all be put into the contract. Accordingly, Mr. Barrows suggested and Mr. Colton agreed, that the contract merely specify "cost of production" and they would let the accountants decide what such cost was. (R. 766-767.)

[8]In the contract as executed, price increases were related to increases in cost in any 12-month period over the preceding 12 months, rather than being related to cost of production in the first year of operation.

It cannot be disputed that it would have been much more advantageous to appellant if the contract had expressly restricted price increases to increases in direct cost of production, as outlined in the draft of agreement transmitted on September 18, 1936, rather than to relate such increases to "cost of production" generally, as appears in the contract. The fact that the contractual language was changed from "direct cost" to the broad term "cost of production" is conclusive proof that the latter term was intended to embrace more than "direct cost". There is no other plausible explanation of the change. Keeping in mind that under the contract, as executed, appellant has the sole right of cancellation, whereas, Mr. Barrows originally intended exactly the reverse, the inference is irresistible that the change in language occurred under the circumstances and for the reasons testified by Mr. Barrows. Mr. Colton admitted that it was not he who suggested the change in the language, and that he would have preferred to have it stay as it was. (R. 1104.) Clearly, if Mr. Colton did not suggest it, Mr. Barrows must have—and for the reason, as he testified, that inasmuch as Mr. Colton not only refused to give California Chemical a cancellation privilege, but insisted that appellant alone have that right, Mr. Barrows was unwilling to confine price increases only to increases in labor, transportation, fuel or supplies, and insisted that they be related to all costs, determined in accordance with good accounting practice.

It was on the basis of this testimony that the court stated that it was "clear" that the parties

intended cost of production to include "all costs that might be shown by accepted accounting practice." (R. 72.) We submit that this is the only reasonable conclusion that could be drawn from the testimony. We submit further that no reasonable inference to the contrary could be drawn from the fact that from four to seven months prior to the execution of the contract, and in connection with a radically different agreement, both as to subject matter and language, Mr. Barrows was willing to confine cost of production to the specific items mentioned in his correspondence at that time.

In discussion of this subject, appellant criticizes the trial court for stating that the record does not show what, if any, cost figures were utilized in fixing the base contract price of $2.80 per ton and argues that the evidence shows that the price was "based upon the average direct cost to California Chemical to produce the materials covered by this agreement during the first years' operation of the contemplated new plant proposed to be erected at Canal Head, Newark, California. * * *" (Appellant's Brief, p. 24.) This quotation is taken from the preliminary draft of agreement transmitted by Mr. Barrows on September 18, 1936, over four months before the contract in final form was entered into. The evidence is uncontradicted, and the contract so states, that construction of the plant was not even commenced until after the contract was executed. (R. 8, 747.) Obviously, the contract price could not, in fact, have been based upon production costs that had not yet been experienced.

Assuming that the price was based upon an estimate of certain costs during the first year of operation, the evidence is conclusive that, because of the radical change in the cancellation privilege insisted upon by Mr. Colton, Mr. Barrows was unwilling to premise future price increases on any restricted items or type of expense.

Appellant states that because gypsum is referred to in the contract as a "by-product", it must be inferred that the parties intended that in determining its cost of production, accounting procedure be followed which, according to appellant's experts, treats by-products different from other products. (Appellant's Brief, p. 21.) Appellant also argues that because there is no testimony in the record that "indirect" or "overhead" costs were ever expressly mentioned in conversations between Mr. Colton and Mr. Barrows, they could not have intended those charges to be included. (Appellant's Brief, p. 24.) Neither point is meritorious. These were two businessmen negotiating a contract. They were not accountants. (R. 797.) It is inconceivable that they had in mind the ethereal distinctions in cost accounting that appellant's experts advocated, as hereinafter discussed, or that in using the term "by-product" in the contract they intended the implications which appellant now attributes to the term. Admittedly there is no evidence that they ever discussed these fine accounting distinctions. However, that proves nothing. The evidence does show that Mr. Barrows suggested that the contract refer to "cost of production" and that they would let the

accountants decide what that is. (R. 766.) Mr. Colton ultimately agreed that this general language be used. (R. 767.) The trial court, with full opportunity to judge the credibility of the witnesses, accepted the testimony of Mr. Barrows and found accordingly. It found further, upon substantial evidence, that good accounting practice requires that overhead and indirect charges be included in cost of production of gypsum, even if it be considered a "by-product".

B. The expert testimony supports the finding.

Appellee's manufacturing processes at its Newark, California, plant are described in a general way at pages 4 and 5 of appellant's brief. The graphic depiction of these processes as shown in plaintiff's Exhibit 16 is sufficiently accurate for our purposes, although it does not show the bromine plant and the course of materials incident to that process. (R. 464, 1244.)

Three main groups of products are produced in appellee's plant—bromine, gypsum and a series of grades of magnesia.[9] As to each of these products, all labor and other expenses related directly and exclusively to its production are charged directly to that product; other expenses, such as general supervision, which contribute to the production of the three products but which, because of their nature, cannot be segregated and charged on a direct time or cost basis to the respective products, are allocated between them.

---

[9]At the time of trial and for some time prior thereto, the production of bromine had been discontinued. (R. 926.)

(R. 904-911.) Direct labor cost, with certain minor exceptions, is used as the allocation factor. Thus, indirect charges are allocated to gypsum in the proportion that the cost of labor directly and exclusively employed in the production of gypsum bears to the sum of the direct labor charges employed respectively in the production of all products. (R. 735-736, 904-911.)

The trial court found not only that the inclusion of overhead expense and indirect charges was proper, but also that appellee's method of allocation has been fair and reasonable. (Finding 9, R. 51.) The expert testimony fully supports these conclusions.

A large part of the record in this case consists of the testimony of accountants. Appellant produced five such witnesses, including Mr. Flick, its vice-president.[10] Appellee produced four.[11] Each witness who testified on the subject, including those produced by appellant, stated that in determining the cost of a manufactured product, it is proper and usual accounting practice to include manufacturing overhead and indirect charges.[12] Appellant's own witnesses conceded that the fact that such charges must be allocated between the various joint products produced in a single plant, and therefore are not precisely determinable in amount, does not detract from the propriety of

---

[10]Draewell, Flick, Jackson, Pryor and Webster.

[11]Alexander, Farquhar, Maxwell and Watt.

[12]Webster (R. 531-532), Pryor (666, 716-717), Jackson (1210), Maxwell (1135-1137), Farquhar (1111-1112), Alexander (1175-1176), and Flick (314, 447).

including them in cost of production.[13] Mr. Pryor stated that this is "common practice." (R. 685.) Mr. Webster referred to it as an "accepted method." (R. 532.) Professor Jackson called it "good accounting practice." (R. 1210.)[14]

Naturally, if several products are being produced in a plant and the production of one of them is discontinued, the overhead expense will nevertheless continue although perhaps in some lesser amount. Still, it is proper accounting to allocate a portion of the overhead to such product while it is being produced. (R. 446-448, 1112-1113, 1137-1138, 1176-1177, 1211.) After discontinuance of production, the overhead thereafter necessarily must be borne by and allocated among the products that continue to be manufactured. (R. 402, 1113.)

Appellant's witnesses, although affirming these general accounting principles and practices, asserted that they apply only to main products or co-products,

---

[13]Flick (R. 315), Webster (532), Pryor (718), and Jackson (1210).

[14]This testimony effectively refutes the argument at page 28 of appellant's brief that overhead is objectionable because the individual items comprising the aggregate account cannot be exactly supported either as to amount or direct relation to production of gypsum. If the items were directly and precisely supportable in these respects they would not be in the overhead account, but would be direct charges. As testified by Mr. Alexander, it is improper to impugn any single item contributing to aggregate overhead merely because it is impossible to prove or disprove precise accuracy of the charge. (R. 1192-1193.) It should be noted also that the overhead figures were prepared by appellee at the request, for the convenience of, and in the form requested by appellant—the individual items are not so allocated on the books. (R. 377-381; see legend, R. 569.)

and not to by-products. It was their opinion that only those expenses that are directly charged and exactly ascertainable in amount should be included in the cost of producing a by-product. (R. 501-502, 635, 668, 718.) They advocated the empirical rule that in the case of a by-product any expense which, because of its nature, has to be allocated is excludable for that reason alone, although it would be entirely proper to include it in the cost of a main product or a co-product. (R. 685, 718.)

The fallacy of this approach may be best illustrated by the testimony of appellant's experts on the subject of indirect shipping expense. The evidence shows that gypsum and magnesia are handled in a single shipping department. (R. 905, 955-956.) There are certain supervisory employees working in this department, such as foremen, who devote their time to the "handling of both products", but who, for practical reasons, cannot record the specific time devoted to each. (R. 904-905.) Accordingly, the expense of these employees necessarily is allocated between the two products in the same manner and for the same reasons that other overhead expense must be allocated. (R. 908.) Approximately as much gypsum is handled in the shipping department as magnesia. (R. 910.) Yet, appellant's experts stated that none of this indirect shipping expense should be charged to gypsum and that it all should be borne by magnesia; consistent with their general approach to the subject of allocated charges, they insisted that this expense must be excluded solely for the reason that it is not precisely

or accurately determinable in amount and therefore must be allocated. (R. 302, 445-448, 521, 694.) The complete lack of any rational basis for this theory was so apparent that even appellant's witness, Mr. Webster, found it impossible to go to that extreme. He finally conceded that under these circumstances it would be proper to charge this indirect expense to gypsum, even though it would have to be on some basis of allocation. (R. 539-540.) In fact, on the general subject of allocated charges he stated only that they are "objectionable but not necessarily totally excludable," depending on circumstances. (R. 536.)

Appellant's experts approached the problem from the viewpoint of a manufacturer who is determining whether it is economically advisable to process a by-product material or to throw it away or "let it wash down the sewer." (R. 503-504, 532, 535, 1203, 1207.) They conceded that their testimony was purely hypothetical and abstract in that they had no familiarity with the plant or processes in question. (R. 522-523, 623-624, 666-667, 1211.) Mr. Webster admitted that if he were called upon by appellee to set up its cost accounting, he would be unable to determine the proper methods and accounting principles to be employed without inspecting the plant and making a thorough study of the operations. (R. 523.) He stated that even as to a by-product, there is no single accounting method to be employed, but that all circumstances must be considered and the accounting methods adapted to the circumstances. (R. 529.) He admitted that in a chemical operation such as ap-

pellee's, where you start with a common raw material and you recover therefrom bromine in one department, gypsum in another, and magnesia in another, the three products might very properly be considered co-products for accounting purposes. (R. 530.) Professor Jackson likewise granted that where a product gets out of the category of waste or scrap, there are authorities who consider it proper, for accounting purposes, to treat it the same as a co-product, although he expressed the opinion that the best authorities are to the contrary. (R. 1220.)

Neither Professor Jackson nor any other expert produced by appellant could cite any text, paper or other authority for the abstract opinions that they expressed on the witness stand, or for their tenuous distinction between "co-product" and "by-product" cost accounting. (R. 470, 553-555, 629, 668-670, 1215-1216.) The record just referred to shows that each of appellant's experts, starting with Mr. Flick, was invited, on cross-examination, to refer to any authority that he might have that would support the theories which he advocated on the witness stand. The successive witnesses had every reason to anticipate that these questions would be put to them. Their inability to substantiate their expert opinions by any outside authority took on added significance under these circumstances and was commented upon by the trial court. (R. 672.) It was admitted that although appellant's experts collaborated in preparation for trial, in the course of those discussions, as well, no reference whatever was made to any authority that would sup-

port the theories which these witnesses advocated. (R. 670.)

Appellee's experts were unanimous in stating that, even assuming gypsum to be a by-product, good accounting practice nevertheless requires that manufacturing overhead and indirect charges be included in determining its cost of production.[15] They took the practical and logical view that merely because overhead expense and indirect charges are not precisely ascertainable in amount, and, in the event of the discontinuance of one of a number of products produced in a plant, such charges would nevertheless continue, although in some lesser amount, there is just as much reason to include those charges in the cost of producing a manufactured product that is designated a "by-product" as there is in the case of a main product, a co-product, or a joint product.[16]

Appellant states at page 20 of its brief that these witnesses recognized that the exclusion of indirect charges from cost of production of a by-product is "an accepted and widely practiced method of accounting—indeed, the method most commonly found in practice." They did not so state, as a reading of the

[15]Maxwell (R. 1135-1138), Farquhar (1010-1013), and Alexander (1175-1183).

[16]Inasmuch as the Court accepted the testimony of these witnesses that it is immaterial for accounting purposes whether gypsum is or is not a by-product, we feel that it is unnecessary to refer to the testimony which, in our opinion, shows that it is not a by-product in accounting nonenclature. Suffice it to say that appellant's contention at p. 21 of its brief, that the reference to "by-product" in the contract is conclusive, is without merit. (*Moffatt v. Bulson*, 96 Cal. 106, 30 Pac. 1022; *Taylor v. Lundblade*, 43 Cal. App. (2d) 638, 111 Pac. (2d) 344.)

testimony referred to by appellant will reveal. The fact is, and it appears from the testimony of appellant's experts, that the most common accounting procedure in the case of a by-product is to keep no cost records at all, but merely to credit the proceeds of sale against the cost of the main product. (R. 530, 624, 1220-1221.) Obviously this is purely an accounting expediency for the convenience of the manufacturer and does not determine cost of production. It is equally true that any method of cost accounting which takes cognizance only of direct costs, to the exclusion of superintendence and other overhead or indirect charges, does not result in a true determination of cost of production, notwithstanding that it may be sufficient for the purposes of the manufacturer.

As stated by Mr. Farquhar, "You cannot obtain true costs of any production without some portion of the overhead." (R. 1111.) He said that in order to "get sound costs, you must absorb that overhead in the various products" (R. 1112), and the fact that you attach the label "by-product" to the product is immaterial. (R. 1115.) He approved direct labor as a "sound basis" for allocating overhead. (R. 1127.)[17] This is the method of allocation employed by appellant itself in its Gerlach plant. (R. 314-316.)

[17]Appellant states that Mr. Farquhar testified that there are "other methods more reliable." (Appellant's Brief p. 28.) This is inaccurate. What the witness stated was that if allocation were made on the basis of the number of laborers, as distinguished from labor costs, there are other ways he would consider more reliable. In the instant case, the allocation is made on the basis of labor costs, rather than the number of laborers.

Mr. Maxwell explained that overhead must be allocated for the very reason that it is not a direct charge, but that this does not detract from the propriety of including it. (R. 1137.) The fact that overhead would continue, although in some lesser or unascertainable amount, even though one of several products were discontinued, regardless of whether that product is deemed a "co-product" or a "by-product", does not alter the fact that "while the product is being produced it should take its pro rata share of overhead." (R. 1137-1138.)

Mr. Alexander stated that "all the proper and accepted methods of accounting are equally applicable in the case of a joint product or a by-product"; that other methods sometimes are employed because of expediency in the particular case, but they do not result in determination of "cost of production." (R. 1178-1179.) This witness was able to testify subjectively, based upon his own inspection of the plant and familiarity with the processes therein. (R. 1179-1183.)[18]

---

[18]Appellant attempts to detract from Mr. Alexander's testimony on the ground that his firm is appellee's regular auditor and he collaborated with appellee in the preparation for trial. (Appellant's Brief, p. 20, footnote 10.) Mr. Alexander's familiarity with appellee's processes and accounting practices adds to rather than detracts from his qualifications. The fact that his firm is appellee's regular auditor does not discredit him any more than the mere fact that Mr. Pryor is a member of Price Waterhouse & Co., which firm is appellant's regular auditor, impeaches his testimony. (R. 173, 633.) The fact that Mr. Flick is an officer of appellant has not deterred appellant from resting heavily on his testimony. We confess to collaboration with Mr. Alexander just as appellant's experts undoubtedly collaborated with its counsel as well as with each other. (R. 670.)

Appellant would have it appear that its experts were better qualified than those produced by appellee. (Appellant's Brief, p. 20, Footnote 10.) We submit that the contrary is true. Of the four independent experts presented by appellant, neither Mr. Draewell nor Mr. Pryor testified to any experience whatever in cost accounting. (R. 621-622, 633-634.) The experts who testified for appellee demonstrated that they were eminently qualified on the subject. Mr. Farquhar has had vast experience in industrial accounting and is west coast representative of a well-known national firm whose practice is predominantly in that field. (R. 1109-1110.) He prepared a manual of cost accounting for the United States Navy Department. (R. 1116-1117.) Mr. Maxwell has practiced since 1921 "with the emphasis on industrial accounting, cost systems, their installations, the determination of costs for various purposes". (R. 1134.) He has had experience in the chemical, automobile, airplane, textile and other industries. (R. 1141.) Several years ago he wrote a treatise "Cost Control for Wineries" in which he asserted, as he did in court, that cost of production of a by-product should include overhead. (R. 1145-1146.) Mr. Alexander has also had experience in cost accounting, and as resident partner of a national firm, keeps himself informed on up-to-date professional knowledge. (R. 1174-1175.) Mr. Watt has had extensive accounting experience since 1919 and since 1933 has devoted himself exclusively to accounting in the chemical industry. (R. 879-880.)

We submit that in light of their qualifications and the logical tenor of their testimony, the trial court was fully justified in attributing the greater weight to the testimony of appellee's experts. The findings of the court are abundantly supported by that testimony, and therefore are not "clearly erroneous."

C. The evidence relating to practical construction of the contract by the parties supports the finding of the trial Court.

In arguing this point, appellant again seeks to place upon a communication from appellee an interpretation that is unwarranted either by the language of the document or the circumstances of its origin. A fair appraisal of the evidence reveals that the court was fully justified in concluding that appellant's conduct in connection with the first price increase indicates that it knew that cost of production, as determined by appellee, included and was intended to include overhead expense and indirect charges. Other reliable evidence, to which the court did not refer in its opinion likewise supports this conclusion.

In August 1941, appellee notified appellant that, effective October 5, 1941, the price of gypsum would be increased to $2.98 per ton by reason of an 18¢ increase in appellee's cost of production. (R. 3.) On October 1, 1946, a conference on the subject was held between Mr. Colton and Mr. Canvin representing appellant, and Mr. Wallace representing appellee. (Pltf's. Ex. 1, R. 100.) Mr. Canvin was appellant's secretary and treasurer. (R. 103.) It was pursuant to his request that the letter of October 2, 1941, was

written enclosing a "recapitulation of labor, material and power costs which accounts for 15¢ per ton of the 18¢ per ton increase." (Pltf's. Ex. 1, R. 100.)

Referring to the recapitulation enclosed with the letter, appellant states that appellee "supported this increase by a statement of the costs which had increased * * *" (Appellant's Brief, p. 25.) That is a palpable distortion of the evidence. The statement showed on its face that it did not purport to "support" the entire increase. It showed only three items of expense and only 15¢ of the 18¢ increase. These figures were furnished at the request of Mr. Canvin following his conference with appellee's accountant at the latter's office. The letter of transmittal expressly stated:

> "If you desire further information in re the attached statement, or in connection with our basis of determining increase in cost, please call on the writer." (R. 100.)

Mr. Canvin knew that the cost of production had increased 18¢. He knew also that the statement showed only three items of cost which aggregated increases of only 15¢. Yet, upon receipt of this statement he did not complain that it was incomplete, nor did he request any "further information" as he had been invited to do. The inference is unavoidable that Mr. Canvin got precisely what he had asked for at the time of the conference, to-wit, a statement only of the items of labor, material and power costs. It is equally apparent that at the time of the conference Mr. Canvin obtained such information as he required

regarding the other items of cost, which the uncontroverted evidence shows included overhead expense and indirect charges. (R. 355.) There is no other logical explanation for his failure to request a statement of all costs upon receipt of the partial statement enclosed with the letter of October 2, 1941.

Appellant in its brief (p. 41) lays great emphasis on the importance which a difference of a few cents in production costs can make over the term of the contract. Yet, it would have this court infer that upon receipt of the statement showing only 15¢ of the 18¢ increase, appellant did not trouble itself about the balance and was content to assume that "the other 3¢ was due to other direct charges of a minor nature", and that "appellant paid the increased price without seeking further detail." (Appellant's Brief, p. 26.) Not only is this completely illogical, but it is unsupported by the evidence. This assertion by appellant is premised on Mr. Flick's testimony that it was not until January 1944 that he knew that the first price increase involved anything other than direct charges. (R. 105; Deft's Ex. A, R. 351-357.) But Mr. Flick did not become affiliated with appellant until July 1942. (R. 95.) He testified that he did not even see the letter of October 2, 1941, until some time in 1943. (R. 99.) Whatever assumptions he may have entertained in 1943 or thereafter are of no significance. There is no evidence that when appellant received the letter and statement of October 2, 1941, and thereafter paid the $2.98 price, it assumed that the 18¢ increase was based only on direct charges. On the contrary,

the evidence hereinabove referred to compels the conclusion that Mr. Canvin knew that the 18¢ increase in cost of production included overhead expense and indirect charges, and that the payments of the $2.98 price thereafter were made with knowledge of that fact.

The evidence is undisputed that in calculating the first price increase appellee included overhead and indirect charges in cost of production. (R. 355.) Such being the case, it cannot very seriously be contended that by its conduct appellee construed the contract as excluding those charges. Nor is there any reasonable basis upon which to infer that because Mr. Canvin requested a statement of three items of direct cost, and because appellee furnished what was requested, appellee thereby construed the contract to mean that "cost of production" included only direct costs.

It is readily understandable from the above why the trial court, in concluding that the contracting parties intended "cost of production" to include all costs, stated that the "parties' conduct with reference to the first price raise supports this conclusion." (R. 72.) It might very well have drawn the same conclusion from the conduct of appellant in other regards. It will be recalled that notice of the second price increase was given in January 1944. (R. 3-4, par. 7.) By that time Mr. Flick had become controller. (R. 95.) He requested a detailed statement of the cost figures in connection with the second price increase and for the first time requested a similar statement

as to the 1941 increase. (Deft's Ex. B, R. 347-349.) Appellee promptly furnished both statements (Deft's Ex. A, R. 351-356), notwithstanding that the first price increase had been an accomplished fact for several years. There was no evasion, delay or reluctance whatever on the part of appellee to furnish a detailed statement of the first increase, such as might have been expected if the partial statement rendered in 1941 had been intended to indicate that the increase was premised only on increases in "direct" cost of production.

Notice of the third price increase was given on September 13, 1946. (Pltf's Ex. 10, R. 219-221.) Shortly thereafter Mr. Flick sent Mr. Bannard, a certified public accountant, to appellee's office to inspect its records and report back to him. (R. 231, 417.) Mr. Flick testified that Mr. Bannard "was thoroughly familiar with my position in respect to all of these accounts." (R. 416.) Mr. Bannard made the inspection and prepared a work sheet upon which he noted all items of cost as shown by appellee's records, and on which he noted all adjustments thereof that he considered should be made. (Deft's Ex. D, R. 419.) Appellee's books showed an increase of 7¢ per ton in overhead. Mr. Bannard made adjustments in three minor items included in overhead. However, with full knowledge of Mr. Flick's position on the subject, he made no adjustment in or objection to overhead, as such, and the ultimate increase of 7¢ per ton remained unadjusted on his work sheet. (R. 419, 432, 434-436.)

At page 26 of its brief, appellant improperly refers to the 1944 statement of costs relating to the 18¢ increase as a "corrected account." There is no inconsistency between this complete account rendered at the request of Mr. Flick and the partial statement rendered in 1941 at the request of Mr. Canvin. Except for a difference of one cent in power cost in the 1940-1941 period, which probably results from a rounding off of decimals, the figures shown in the 1944 statement for the three items covered by the 1941 statement are identical, as the following recapitulation demonstrates:

	1941 Statement	1944 Statement
Period 1939-40	(R. 100)	R. 355)
Labor	.30	.30
Materials	.12	.12
Power	.11	.11
Period 1940-41		
Labor	.32	.32
Materials	.22	.22
Power	.14	.13

Appellant states that the form of the 1941 letter and statement were not such as to put appellant "on notice that indirect charges were being included." (Appellant's Brief, p. 27.) There is nothing in the contract requiring appellee to put appellant "on notice" or even to furnish a statement of cost of production. The contract provides only that appellee's records "shall be open to inspection" of appellant. (Par. (6), R. 11.) This is a privilege of which appellant has freely availed itself. Even if it were not a fact that, as the evidence indicates, Mr. Canvin ascertained that "in-

direct charges were included", it still would not change the fact that such charges have been included by appellee in determining cost of production ever since the inception of the contract. Hence, there is no validity to the argument that appellee, by its conduct, has construed the contract to exclude overhead and indirect charges. The reliable evidence is all the other way.

D. The fact that the contract provides that price increases shall be based on "actual advance" in appellee's cost of manufacture, does not require the exclusion of "indirect" costs.

Appellant's argument of this point is merely a variation of its basic contention, which was rejected by the trial court, that overhead and indirect charges are not includable in cost of production because they must, of necessity, be allocated and therefore are not precisely provable in amount. We have already shown that the evidence fully sustains the finding that in using the synonymous terms "cost of production" and "cost of manufacture", the parties intended the inclusion of all costs, determined in accordance with good accounting practice, and that such costs include overhead and indirect charges. (R. 51.)

It is axiomatic that if cost of production, determined in accordance with good accounting practice in one period exceeds the cost so determined in another period, an "actual" increase has occurred. Webster's dictionary defines "actual" as something that is "factual". Certainly no manufacturer would dispute for a moment that if the salaries of his manager,

superintendents, foremen, clerical help or any other type of general or administrative employee increase, the additional expense is both "actual" and "factual". These expenses must be paid just as certainly as any "direct" expense and the resultant increase in "cost of production" is painfully "actual".

The cases cited by appellant construing the term "actual cost" have no application to this case. That is not the language of the contract. The contract refers to "cost of production". The restriction of price increases to "actual increase" in "cost of production" in no wise controls the method to be employed in determining cost of production and whether an increase has occurred and thereby become "actual". The question as to whether or not overhead and indirect expense are includable in "cost of production" is to be determined according to what the term means as used in this particular contract. Accordingly, it would serve no purpose to review and further distinguish the authorities cited by appellant. For every case in which it has been held that under the circumstances of the particular case the term "cost" as used in a contract or statute includes overhead or indirect charges, another case may be found in which, under the circumstances of that case, a contrary conclusion has been reached.[19]

---

[19] *Fillmore v. Johnson,* 221 Mass. 406, 109 N.E. 153;
Boston Molasses Co. v. Molasses Distributors Corp., 274 Mass. 589, 175 N.E. 150;
Fort Dearborn Trust & Savings Bank v. Skelly Oil, 146 Okla. 179, 293 Pac. 557.

As stated in *State v. Northwest Poultry & Egg Co.*, 203 Minn. 438, 281 N.W. 753:

> " 'Actual cost' has no common-law significance, and it is without any well understood trade or technical meaning. 'It is a general or descriptive term which may have varying meanings according to the circumstances in which it is used.' * * * Its meaning may be restricted to overhead or extended to other items. * * * It has been used to include overhead, rent, depreciation, taxes, insurance, etc."

Similarly, in *Finn v. Culberhouse,* 105 Ark. 197, 150 S.W. 698, the court stated:

> "It has generally been said in the adjudged cases that such terms as 'actual cost', 'estimated cost', 'first cost', 'original cost', 'prime cost', and 'whole cost' are indefinite, and that surrounding circumstances must often be looked to in order to arrive at a proper interpretation. (Citing cases.)"

Of particular interest is *Myers v. The Texas Company,* 6 Cal. (2d) 610, 59 P. (2d) 132. That case involved an oil lease which did "not obligate the defendant to extract gasoline from the natural gas," but provided that if it did, lessee should pay lessor one-sixth of the proceeds "after deducting the cost of extraction". The court observed that the "possible extraction of gasoline was only an incident to the main undertaking," just as appellant claims that the production of gypsum is only incidental to the production of magnesia. In construing the meaning of the contract the court held that depreciation, insurance, ad-

ministration or bookkeeping expenses and taxes (all of which necessarily were "indirect charges") were properly includable in determining "cost of extraction". The court stated at p. 619:

> "* * * We agree with appellants that the word 'cost' is a word of variable meaning and that it must be construed according to the circumstances in which it is used. A review of the authorities is of little value, except to illustrate the fact just stated that, in order to arrive at the intent with which it was used in the particular case, the word is to be construed in the light of all attending circumstances. * * *"

Thus, in this case the trial court, in light of the contractual language and all attending circumstances, found on substantial evidence that "cost of production" means and was intended to mean all costs, including overhead and indirect charges. Appellant's own witnesses admitted that in the case of a coproduct it is usual and good accounting practice to include such charges, even though of necessity they must be allocated and are not precisely determinable in amount. The court agreed with appellee's experts that the same accounting procedure is applicable in this case. It properly concluded that an increase calculated in accordance with good accounting practice is "actual" within the meaning and intent of the contract. These findings are supported by a plethora of substantial evidence, and are not clearly erroneous.

IV.

THE TRIAL COURT PROPERLY FOUND THAT THE DETERMINATION OF COST OF PRODUCTION OF GYPSUM BY APPELLEE FROM TIME TO TIME HAS BEEN IN ACCORDANCE WITH THE PROVISIONS OF THE CONTRACT.

At pages 50 and 51 of its brief appellant has tabulated the items of cost involved in the second and third price increases which it disputes and has indicated the reasons for its objections thereto. In the ensuing argument we will deal separately with each of the disputed items.

A. Plant overhead.

This item is designed as "other overhead" in the tabulation of disputed items. It consists of the overhead at the Newark plant after eliminating all research expense and the items designated as "West Coast" expenses. It is undisputed that the aggregate overhead expense was incurred by appellee and the evidence shows that the allocation thereof to gypsum was made in accordance with good accounting practice. Appellant's objection to this item is based on its extreme position that not even manufacturing overhead is includable in cost of production of gypsum, for the reason that it must be allocated and is not precisely determinable in amount.[20] (Appellant's Brief, pp. 27-34.) In our prior discussion, we have shown

[20]Appellant is not consistent even in this regard. The record shows that taxes and insurance are allocated items included by appellee in cost of production. (R. 276, 557.) Yet, appellant takes no exception to these items. (Appellant's Brief p. 5, Footnote 4; p. 52, Footnote 15.)

that the court was fully justified in finding that, under the terms of the contract, this expense is and was intended by the contracting parties to be included in cost of production, and that good accounting practice compels such inclusion. The evidence not only is sufficient to support the finding, but preponderates in favor thereof.

B. New Products Research.

Appellee's research laboratory is devoted to testing of products, improving processes, working out new analyses, and developing new products to be derived from the raw material. (R. 907-908.) The indirect charges in the laboratory are allocated to the various products produced in the plant in the proportions that the cost of the laboratory services directly and exclusively employed in connection with the respective products bears to the total of such direct charges. (R. 907-908.) In the year 1943, 6.78% of "new products" research, or the sum of $2,804, was allocated to gypsum, and the sum of $243 was charged to gypsum on a direct basis. (R. 354.) For the 12-month period ending June 30, 1945, the aggregate charge against gypsum was $1,194.13 and in the 12 months ending June 30, 1946, it was $2,622.15. (R. 569.) No evidence was introduced showing the breakdown of these items in the latter periods as between direct and indirect charges. Nor, was there any evidence as to what proportion of the aggregate charges in those periods was for "new products" research and what proportion was for general research, including improvement of processes and

working out of analyses. Although at page 51 of its brief, appellant takes exception to all research charges, whether for new products or not, the only objection argued in the brief is to "new products" research. From this we assume that appellant's objection to the research charges in the latter periods is upon the broad ground that it is a portion of overhead and is excludable for that reason alone. That objection has been fully covered in sections III and IVA of our argument.

Appellant's argument against charging any part of new products research expense against gypsum is premised upon the assumption that it is "totally unrelated to gypsum." (Appellant's Brief, p. 35.) This assertion is based upon the testimony of Mr. Flick, who, admittedly, is not a chemist. (R. 125.) Appellant likewise relies upon other testimony that is taken out of context and severely strained. Mr. Wallace testified that some research had been conducted as to the possibility of making a different product than gypsum from the sulphate. (R. 1093.) He was asked whether some of that research had been allocated against gypsum to which he replied, "that it very likely could have been." (R. 1094.) There was no evidence as to the amount expended in this research. In cross-examination of Mr. Alexander he was asked whether the expense of that specific research project "which obviously could in no way benefit the plaintiff in this case" should be allocated against gypsum. He expressed the frank opinion that it should not, but emphasized that

this opinion was restricted, and that "it is that specific thing that I would not allocate." (R. 1195.) He did not state that new products research, generally, is an improper charge.

Appellant's reference to the testimony of Mr. Farquhar likewise shows the weakness of its position. He was asked, purely hypothetically, as to whether overhead "wholly disassociated from the manufacture of a particular product" should be charged against such product and he answered in the negative. (R. 1132.) Here again the assumption was that the research charges were "totally unrelated to gypsum" and "wholly disassociated" from the manufacture thereof. There is no evidence to support these assumptions. Every reasonable inference from the evidence is to the contrary.

As has been pointed out, overhead expense and indirect charges at appellee's plant are allocated among the various products there produced. (R. 276, 557, 558.) The greater the number of products the less is the percentage of these charges to be allocated to each. The evidence shows that a number of new products derivable from bittern have been developed in the research laboratory. (R. 1022.) Thus, it is obvious that the development of new products through the research laboratory operates, costwise, to the benefit of all products produced in the plant, including gypsum. This directly benefits appellant in that the less overhead chargeable to gypsum, the less the cost of production which may result in price increases under the con-

tract. That is what Mr. Williams had in mind in his discussion with Mr. Flick. (R. 175.) At page 35 of its brief, appellant states that Mr. Williams "admitted that appellant's objections to this charge are justified." That is a manifest misinterpretation of the testimony. He did state that he thought appellant was justified in questioning the charge for new products research. Obviously, what he had in mind is that the designation of the account is misleading, because in the next sentence Mr. Williams stated that "the research was for the Newark plant, California, only, and it would result in bringing down the plant cost and therefore ought to be included." (R. 175.)

A good example of how new products research may benefit appellant is furnished in the case of sulphuric acid expense. Upon cessation of production of ethylene dibromide at appellee's plant, sulphuric acid which formerly was charged to the cost of that product had to be charged to gypsum, and that is one of the charges to which appellant takes exception. (See section IV F, infra.) Should a new product be developed to use the bromine, it might permit the continuous operation of the bromine plant and eliminate any further sulphuric acid charge against gypsum.

It is a truism of chemical research that one does not expect each experiment to be successful. It is only in the aggregate over a period of time that such expenditures are productive, but it is commonplace that in our system spectacular reductions in cost are the result of scientific research, and this court can take judicial

notice of the fact that research is a necessity in modern technology. It is for that reason and upon the grounds above stated that Mr. Watt and Mr. Alexander approved the allocation to gypsum of a reasonable percentage of appellee's research costs at its Newark plant. (R. 935, 936, 1184.)

C. General and administrative expenses.

As previously mentioned, the accounting sheets comprising Plaintiff's Exhibit 18 were prepared by Mr. Flick. (See Footnote 14, supra.) Mr. Watt explained that the designation of "West Coast" expenses as appears at R. 569, is not the designation under which the items are carried on appellee's books. (R. 1049.) He stated that these items constitute "expense incurred in Newark for the Newark plant" and are wholly "unrelated to any other West Coast operation" of appellee. (R. 1049-1050.) A portion of this aggregate expense incurred at the Newark plant is charged to two other plants operated by appellee in California so that the Newark plant bears only its proportion of the total. (R. 930-931.) Appellant's objection to these items is based on the erroneous assumption that they are disassociated from manufacturing operations at the Newark plant. (Appellant's Brief, p. 38.) Mr. Watt's testimony is to the contrary. Consequently, the fact that appellee's witnesses testified that only "factory" or "plant" overhead should be included, does not exclude the items in question.

Mr. Farquhar testified as follows:

> "Well, cost of production may have a considerable share of the administrative expense where selling is very little. Going back to my Navy experience, there was no selling expense after the contracts, and all the administrative expense was apportioned as overhead and acknowledged as overhead and paid for by the United States Government, the Navy Department, as part of the cost of building destroyers. There was just a minute amount left for selling." (R. 1132.)

In the instant case, substantially all of the gypsum manufactured is sold to appellant under the contract and there is no selling expense whatever. Accordingly, the inclusion of the general and administrative expenses designated as "West Coast" is entirely consistent with the testimony of appellee's experts and is expressly approved by the above testimony of Mr. Farquhar as well as that of Mr. Alexander. (R. 1183, 1192.)

What has been said applies equally to the item designated "West Coast, New York Office". Having in mind that the Newark plant of appellee is one of a number of plants throughout the country, it is obviously not a completely integrated unit. The evidence shows that appellee maintains four floors of offices and 150 employees in New York. (R. 1081.) It must be assumed that this expense is not incurred unnecessarily, and that the general supervisory services thereby rendered are both necessary to and beneficial in the operation of the manufacturing processes conducted at the Newark plant. The evidence shows that

in the period 1945-1946, the aggregate amount allocated to gypsum for New York office expense was $671. There is no evidence that this charge was excessive or that the services of the home office were not necessary to the operation of the Newark plant.

We submit that the inclusion of these general and administrative expenses is supported both by the evidence and by common sense.

D. Indirect shipping and air compressor charges.

Mr. Watt pointed out that as to indirect shipping expense the allocation was changed from use of a value basis to a tonnage basis for the very obvious reason that the volume of a product that is handled and shipped, rather than the value, is the true measure of the labor and expense that is involved. (R. 958.) As he stated, "the truth of shipping is the tonnage that is shipped." (R. 959.) As to the air compressor charge, he explained that this had previously been included in general overhead, but was changed so as to allocate the expense among the products produced according to a study made by the maintenance department as to the respective times that the compressor was used directly in the handling or production of the various products. (R. 1006-1007, 1009-1011.)

The evidence shows that appellee has employed the same accounting procedures with regard to gypsum as have been applied to the other products produced at the Newark plant. (R. 910, 929.) Mr. Watt stated that these accounting changes were not adopted for the purpose of giving gypsum adverse accounting

treatment or even with a view as to what the future effect on gypsum cost would be. (R. 957-958.)

They were made to refine or improve the methods previously employed in order to arrive at a more accurate result in segregating the charges. (R. 958, 1010.) Accounting is not an exact science but one that is based on judgment and experience. As stated by Professor Jackson, it is supposed to be "good common sense." (R. 1210.) It must have been contemplated by the businessmen who negotiated this contract that accounting techniques would not remain static during the 25 year term of the agreement.

At the time the contract was entered into the parties agreed to leave the determination of cost of production to the accountants, and that such cost be determined in accordance with good accounting practice. In our opinion the accounting changes that were adopted were consistent with this general understanding and intent. The trial court was of the same view. Should this court feel otherwise, the adjustment of 3¢ per ton from November 13, 1946, readily may be made without the necessity of any further proceedings.

It is pure coincidence that the 3¢ involved in these two items is the same amount that appellant now states it considered so insignificant in connection with the first price increase that it was willing to assume in that instance that "it was due to other direct charges of a minor nature", and which appellant was willing to pay "without seeking further details." (Appellant's Brief, p. 26.) Appellant attaches much greater im-

portance to the amount when it serves its purpose to do so. (Appellant's Brief, p. 41.)

The only other change in accounting methods referred to by appellant is with reference to the allocation of overhead expense. (Appellant's Brief, p. 42.) There is no evidence that this change resulted either in an increase or decrease in the cost of producing gypsum.

E. Straight line depreciation.

Ever since construction of its plant appellee has calculated its annual depreciation charges on a "straight line" basis whereby the cost of equipment is charged off in equal annual amounts over the term of its estimated life. (R. 440, 902.) Mr. Alexander testified that this is the "best way of determining depreciation that we have before us in most cases." (R. 1184.) Appellant admits that the method is a "common one" and is "widely used". (Appellant's Brief, pp. 46, 48.) However, it argues that straight line depreciation is "hypothetical or theoretical" and that for the purpose of this contract appellee should base its annual depreciation charge on the "amount of gypsum that could be produced over the total life of the machinery." (Appellant's Brief, p. 46.)

This argument is purely one of convenience and self-interest. It is without support in the record and has nothing to commend it except that the production method would result in an advantage to appellant. The uncontradicted testimony shows that the only true measure of depreciation that occurs in the gypsum

plant is the time element rather than the quantity of gypsum produced. The predominant cause of depreciation is the corrosion that normally attacks machinery in a chemical plant. (R. 901-902, 1184-1185.) There is no "variance in the corrosion or wearing of equipment according to the quantity of production produced in it." (R. 901.) Mr. Alexander explained the matter as follows:

> "It (the gypsum plant) is not to be compared with a machine tool where a good industrial engineer would perhaps estimate it would produce so many items. Not this equipment. From all the information I could gather, it wears out on a time basis which calls for what has been spoken of—it has been used in this courtroom—straight line depreciation." (R. 1185.)

Appellant argues that "the equipment does not wear out faster because less tonnage goes through it." (Appellant's Brief, p. 47.) The significant fact is that the equipment will not last any longer notwithstanding that "less tonnage goes through it." The corrosion will necessitate replacement of the plant in a certain number of years regardless of the tonnage of gypsum that is produced. Obviously, therefore, depreciation charges computed on the basis of the life of the equipment will most reliably "reflect the actual wearing out" thereof and is best calculated to accumulate in the depreciation reserve an amount sufficient to replace the equipment at the end of its useful life. There is no evidence to the contrary, except the hypothetical testimony of appellant's expert witnesses. However, the corrosion factor was not

brought to their attention and was not considered by them in their testimony. Appellant's witness, Mr. Webster, admitted that the depreciation method to be employed in a particular case "is not strictly an accounting problem" but depends "to a large degree on the circumstances." (R. 514.) The only subjective testimony in the record proves that under the circumstances of this case straight line depreciation is the most reliable method.

The crux of appellant's criticism of straight line depreciation is that because the depreciation charges are in equal annual amounts the per unit charge will fluctuate with variations in the quantity of gypsum produced. That is not a valid objection. It is merely the inescapable consequence of the employment of a sound accounting procedure. It is plain common sense and a general economic principle that cost of production will vary according to the quantity of product produced. The greater the volume of production during a fixed period, with other conditions remaining the same, the less the unit cost. There is no way of avoiding the operation of this natural law. (R. 1188.) It applies not only to depreciation, but operates as well upon other charges, whether of a direct or indirect nature. Thus the amount of taxes and insurance per unit of production will vary inversely according to the quantity produced, even though the dollar amount remains the same. This is equally true of superintendence. And in a manufacturing process that is largely automatic, such as this one is, it probably would take as much direct labor

to produce 20,000 tons of gypsum per year as it would 30,000 tons. Hence, even as to this direct expense an increase in per unit cost will result when there is a decrease in the quantity of production. And if there were a decrease in wage scales, this could be true even in the event of a decrease in the dollar amount of direct labor. The fact that depreciation cost per unit will fluctuate according to the quantity of gypsum produced, in the same manner as will other expenses, does not require that this charge be computed according to a formula that constitutes a departure from usual and proper accounting procedure, and which is not calculated to depreciate the property over the term of its estimated life.

Appellant's claim that straight line depreciation is "hypothetical or theoretical" is equally devoid of merit. There is no evidence that the aggregate production capacity of the gypsum plant can be estimated with greater accuracy than can its life in terms of years. Regardless of the amount of production the gypsum plant will withstand the onslaughts of corrosion only for a certain number of years. Consequently, in order to arrive at an annual depreciation charge by the production method, it would be necessary to estimate the quantity of gypsum that will be produced by appellee during those years. The evidence shows that there have been substantial variations in the volume of gypsum produced by appellee during different 12-month periods in the past. (R. 565.) What amount will be produced in future years is particularly conjectural in that under the contract appellant may re-

duce its purchases to 20,000 tons per year, or may cancel the contract entirely. Certainly there is no evidence or reason to assume that depreciation calculated on estimated production during estimated life would be less "hypothetical or theoretical" than depreciation based only on estimated life. We fail to see how the introduction of two estimated factors in a depreciation formula can result in greater certainty than a formula that involves only one such factor.

Appellant has entirely misconstrued the holding in *McCardle v. Indianapolis Co.,* 272 U.S. 400. The Supreme Court did not condemn the charging of annual depreciation on a straight line basis. The question before the court was the determination of the present value of the utility property for rate-making purposes. With reference to the depreciation that had accrued at the time of the inquiry, the court stated:

> "The testimony of competent valuation engineers who examined the property and made estimates in respect to its condition is to be preferred to mere calculations based on averages and assumed probabilities."

For the same reason that the Supreme Court rejected a calculation on the straight line basis for the purpose of determining accrued depreciation, it would also reject a calculation made on the production method. It would accept the testimony of competent engineers who had examined the property and observed the depreciation that has occurred in preference to a mere calculation made on either basis

The evidence conclusively shows that under the circumstances of this case the straight line method of depreciation is the only reliable basis upon which to charge off the gypsum plant and create a reserve adequate to replace the property at the end of its useful life. There is no conflict in the evidence in that regard. The extent of the testimony of appellant's witnesses was that the production method would be more advantageous to appellant. They did not state that it would reflect the wearing out of the plant. There is nothing in the contract or the evidence that requires a departure from this usual accounting procedure that has been employed by appellee consistently throughout the years. The trial court had no alternative but to approve straight line depreciation.

F. Sulphuric acid.

Appellant objects to the charge of 23¢ for the sulphuric acid that first occurred in the period of July 1, 1945, to June 30, 1946. (R. 565.) It contends that this charge resulted from a change in accounting methods. That is not true. The fact is that the charge appeared for the first time in this period because of a basic change in the manufacturing processes at the Newark plant.

Operations at the Newark plant commenced in 1930 or 1931 at which time the bromine unit constituted the entire plant and bromine was the only product produced. (R. 743.) From the inception of operations and when bromine was the sole product sulphuric acid

was used in its production. Naturally the cost of the acid was charged to bromine. (R. 832.)

The gypsum and magnesia plants were constructed in 1937. (R. 747.) When the three plants are in operation the bittern passes first to the bromine plant, then to the gypsum plant, and finally to the magnesia plant. Defendant's chemist, Mr. Melhase, explained that when the bromine plant is operated sulphuric acid is necessary to improve the chlorine efficiency to enable the recovery of bromine. (R. 808.) The function of the acid in the production of gypsum is to decrease the amount of organic material and alter the size and shape of the gypsum crystals to facilitate further processing. (R. 808.) As the result of a test that was run in appellee's plant in which an attempt was made to produce gypsum without adding sulphuric acid to the bittern, it was determined that the product could not be satisfactorily dried due to the absence of the acid. (R. 809.) Sulphuric acid is not necessary to the production of magnesia; the magnesia that was produced during the period that the above test was run proved to be satisfactory notwithstanding the absence of the acid. (R. 808, 1247-1248.)

Ever since the commencement of operations at the Newark plant it has been the consistent accounting procedure to charge the sulphuric acid against bromine, when that product was being produced. (R. 926.) However, the production of bromine was discontinued in September 1945, and from that time on the sulphuric acid was charged to gypsum, except for a brief period in 1946 when bromine production was

temporarily resumed. (R. 926-927.) It is established by reliable evidence that sulphuric acid is necessary to the production of gypsum but is not necessary for magnesia. Obviously, when the production of bromine was discontinued it was entirely proper, indeed, it was essential, to charge the expense of the acid against gypsum which then became the only product in production that required the acid for its manufacture. In the entire history of the company there has never been a charge against magnesia for sulphuric acid. (R. 927.)

It is readily apparent from the above that the fact that the sulphuric acid charge against gypsum first appeared in the 1945-1946 period resulted from a basic change in the operating conditions at the plant rather than from a change in accounting procedure. It was a new charge to gypsum necessitated from this change in circumstances. The propriety of the charge is substantiated by the testimony of appellant's witnesses, Messrs. Pryor and Webster. Mr. Pryor stated that there is nothing wrong in including "a new expense" that did not occur in a previous period. (R. 687.) He conceded that the sulphuric acid charge might have resulted from a change of circumstances rather than a change of accounting practice. (R. 707.) Mr. Webster testified that a new expense that arises in the course of the manufacture of a product by reason of a change in circumstances that did not exist in a prior period would, as a matter of accounting, represent an increase in the cost of production in the second period as compared to the first;

he conceded that if the sulphuric acid were used only for the purpose of producing gypsum it would be a proper charge to gypsum. (R. 513, 549.)

With relation to other items entering into cost of production, appellant has insisted that accounting methods must be consistent. In this instance, however, it is equally vociferous in asserting that appellee should depart from the accounting procedure that it consistently employed from the very inception of its operations. It cannot be denied that it would be highly improper to charge any portion of the sulphuric acid to magnesia, for the production of which it is unnecessary. It must be conceded that as a basic raw material it must be charged somewhere, and when bromine is not produced there is no place to charge it other than to gypsum, the only product for the production of which it is required.

In light of the evidence, we submit that the trial court was fully justified in approving the sulphuric acid charge.[21]

G. Bittern.

Although this is one of the items to which exception is taken at page 51 of its brief, appellant has not undertaken to argue the subject, probably for the

---

[21]In footnotes 3 and 14 of its brief, appellant has assumed to refer to the fourth price increase which occurred since the entry of judgment. We submit that this is highly improper. Inasmuch as the details and facts pertaining to this increase are not a part of the record, it would be purposeless to discuss the subject and we do not propose to be lured into argument of any matter that is not properly before the court.

reason that in connection with the last price increase there was a reduction of 2¢ per ton in this item. (R. 565.) It appears to us that it is obvious on its face that gypsum should bear some part of the cost of the very raw material from which it is derived. Naturally, there is no precise basis upon which to determine the amount of bittern utilized in the production of each of the various chemical products extracted therefrom. Consequently, a certain "arbitrary" percentage of the bittern cost has been allocated to gypsum. (R. 927-928.) This percentage has been consistent throughout the term of the contract. (R. 1057, 1059-1060.) The evidence sustains this as good accounting practice.

V.

APPELLANT HAD THE BURDEN OF PROVING THE ALLEGATIONS OF ITS COMPLAINT.

Appellant asserts that the court below reached its decision that appellee had properly determined cost of production upon the ground that appellant had failed to prove that appellee's records were improperly kept, and that the price increases were unjustified. (Appellant's Brief, p. 52.) This is only partially true. It expressly appears from the foregoing discussion that the court based its decision also upon convincing evidence that the parties intended, and good accounting practice requires, that overhead and indirect charges be included in determining appellee's cost of producing gypsum. The court stated in its opinion that it was "clear to the court that when the

parties used the term 'cost of production' they intended it to include all costs that might be shown by accepted accounting practice"; and that the evidence showed that under accepted accounting practice it is proper to "charge to a by-product a proportionate share of indirect and overhead as well as the direct costs." (R. 72-73.)

The fact is that it cannot be ascertained from the record to what extent the trial court felt that appellant had the burden of proof. Throughout the trial of this case, appellant assumed the prerogatives and accepted the benefits of the party having the affirmative of the issue. Both in the presentation of evidence and in written and oral argument appellant both opened and closed. (R. 1170.) The trial commenced on December 8, 1947. It was not until December 23rd that appellee had the opportunity to commence presentation of its evidence. (R. 742.) In the interim, appellant produced its witnesses who testified at great length on all phases of the case, and introduced 20 written exhibits. After appellant had completed its case and appellee was about to present its proof appellant for the first time mentioned the subject of burden of proof. (R. 737.) However, the court was not asked to rule upon the point at that or any subsequent time.

It is our position that both on the general question as to whether overhead and indirect charges are includable, and also as to the specific accounting items in dispute and the matter of sampling, the burden of proof was upon appellant.

It was alleged in appellant's complaint that appellant paid appellee at the price of $3.76 per ton for all gypsum delivered under the contract between September 4, 1946, and November 12, 1946, and at the rate of $4.48 per ton for gypsum delivered from November 13, 1946, to and including January 31, 1947. (R. 4-5.) Referring to the price increase to $3.76 per ton claimed by appellee, appellant alleged in paragraph 7 of its complaint that appellee's cost of production of gypsum "had so increased not more than 29¢ per ton" during the period in question and, therefore, that appellee "was entitled to be paid not more than $3.27 per ton for gypsum delivered under said contract on and after March 15, 1944"; that as to the payments made by appellant at the rate of $3.76 per ton, such "payments were in excess of the price properly chargeable by defendant under said contract by not less than 49¢ per ton, or a total sum of not less than $2,494.59." (R. 4.)

In paragraph 8 of its complaint, identical allegations, different only as to the respective amounts involved, were set forth with reference to the price increase to $4.48 per ton, it being alleged that the payments made by appellant to appellee from November 13, 1946, to and including January 31, 1947, were excessive in the "total sum of not less than $6,911.34." (R. 5.)

In paragraph 9 of the complaint, appellant alleged that appellee had erroneously construed the term "cost of production" as used in paragraph (6) of the con-

tract, and that appellee "through the use of improper accounting and other methods, determined its cost of production of gypsum." (R. 5.)

Based on these allegations, appellant prayed for a declaratory judgment as to the meaning of the contract, and also for affirmative relief by way of a money judgment for $9,405.93.

Appellant argues that the burden of proof was on appellee to prove the increases in its cost of production, on the ground that appellant's allegations were negative in form and the allegations in appellee's answer were in the affirmative. (Appellant's Brief, p. 58.) It is apparent from a reading of appellee's answer that the allegations referred to constitute nothing more than a denial of appellant's allegation that appellee's cost had increased "not more than 29¢ per ton" and that the denial necessarily was stated in affirmative form in order to avoid a negative pregnant. The fact of the matter is that the charging allegations of appellant's complaint were in the affirmative. Appellant was in the position of a litigant asserting the affirmative of an issue and seeking affirmative relief. It had paid the increased prices claimed by appellee but claimed that it had overpaid and sought judgment for the alleged excess. Thus, it was alleged that appellee's cost of production had increased not more than an alleged amount per ton; that appellee was entitled to be paid not more than a specified price per ton during the respective periods in question; that the payments made by appellant were in excess of the price properly chargeable by appellee in an amount of not less than $9,405.93; and that appellee had de-

termined its cost of production through the use of improper accounting and other methods. In order to recover the money judgment that is sought, appellant was obliged to prove that its payments had exceeded the amounts payable under the contract. In order to show that, it was incumbent on appellant to prove the amount "properly chargeable" under the contract, and in order to make this proof, appellant necessarily would have to prove not only the meaning of the contract, but also the proper cost figures derivable thereunder. Certainly appellant could not shift this burden of proof to appellee through the simple device of coupling its affirmative claim with a prayer for declaratory relief.

But even if it were true, which it is not, that appellant's allegations were negative in form, appellant, nevertheless, would have had the burden of proving the facts it alleged.

In *Travelers Ins. Co. v. Drumheller* (W.D. Mo. 1938), 25 F. Supp. 606, wherein an insurance company brought suit for a declaratory judgment that it was not liable under an accident policy, the court stated:

> " * * * If an insurance company, which, normally, would be defendant in an action to enforce a contract of insurance, desires, for the sake of certain advantages, to initiate the proceeding and to become plaintiff, it must assume the ordinary burdens of a plaintiff. Asking a judgment that it is not liable, it must prove it is not liable. In this case it can do that only by proving the insured did not die from accident."

Section 1981 of the Code of Civil Procedure of California provides:

> "The party holding the affirmative of the issue must produce the evidence to prove it; therefore, the burden of proof lies on the party who would be defeated if no evidence were given on either side."

It cannot be questioned that if no evidence were produced by either party in the trial court, appellant could not have recovered judgment for the excess payments that it allegedly made. It is equally clear that in such event the court would have had no record upon which to find, in accordance with the affirmative allegations of the complaint, that appellee's cost of production "had increased" not more than the alleged amount per ton, or that appellee "had determined" its cost of production through the use of improper accounting or other methods. It was by the application of this principle that the court in *Roadside Rest, Inc., v. Lankershim Estate* (1946), 76 Cal. App. (2d) 525, 173 P. (2d) 554, held that the plaintiff in the declaratory relief action had the burden of proving the allegations of its complaint.[22] To the same effect see *Dunn v. County of Santa Cruz,* 67 Cal. App. (2d) 400, 154 P. (2d) 440.

Thus, it is clear that under the law of California, appellant had the burden of proof, and it is that law which controls the determination of the question.

---

[22]In citing this case at pp. 55 and 56 of its brief, appellant omitted the Court's reference to that portion of CCP 1981 which states that the burden is on the party who would be defeated if no evidence were given on either side.

(Cities Service Oil Company v. Dunlap, 308 U.S. 208; *State Farm Mut. Automobile Ins. Co. v. Smith* (W.D. Mo.), 48 Fed. Supp. 570, 572.) Accordingly the state court decisions cited in appellant's brief have no application. Furthermore, none of the cases upon which appellant relies sustains its position. No authority has been cited by appellant, either state or federal, that holds that in a declaratory relief action the defendant has the burden of proving the affirmative allegations of the plaintiff's complaint. Certainly, none of the cases hold that the burden of proof is on the defendant to prove the allegations of the complaint upon which plaintiff seeks a money judgment.

It is interesting to note that *Travelers Ins. Co. v. Greenough* (1937), 88 N.H. 391, 190 Atl. 129, which appellant states is the leading case on the subject, has been expressly repudiated and held inapplicable to declaratory relief actions under the Federal Statute. That action was brought under the New Hampshire Declaratory Judgment Act. In *Travelers Ins. Co. v. Drumheller,* supra, the insurance company brought suit under the Federal Act for a declaration that it was not liable under an accident policy on the ground that the insured died from natural causes. On the authority of the *Greenough* case, the company contended that because the burden of proof as to cause of death would have been on the beneficiary in an action on the policy, the defendant had the burden of proof in the declaratory relief action. The federal court observed that the *Greenough* case turned "upon the law of the New Hampshire Act" and that insofar

as the reasoning of that case would fit the federal statute the court "did not agree with that reasoning." Consequently the court held as follows:

> "* * * One who comes into court asking a judgment against another, whether it be a declaratory judgment only or one capable of immediate enforcement, must prove that he is entitled to that judgment. * * *"

In *Reliance Life Ins. Co. v. Burgess* (8 Cir. 1940), 112 Fed. (2d) 234, one of the cases cited by appellant, the court applied the identical principle that obtains in California. There, the insurance company brought suit for a declaratory judgment as to its liability under a double indemnity provision of a life insurance policy. The court held that the burden of proof rested on the plaintiff in the first instance, although perhaps the burden of "going forward with the evidence" shifted from time to time as the trial progressed. The actual holding of the court was as follows (p. 238):

> "It is a fundamental rule that the burden of proof in its primary sense rests upon the party who, as determined by the pleadings, asserts the affirmative of an issue and it remains there until the termination of the action. It is generally upon the party who will be defeated if no evidence relating to the issue is given on either side."

Appellant has cited *Thompson v. Baltimore & O. R. Co.,* 59 Fed. Supp. 21, as holding that a defendant in a declaratory relief action may have the burden of proof. The fact is that in that case the court held (p. 28):

> "Plaintiffs assert the affirmative of these issues and therefore plaintiffs must carry the burden of proof. That this is a suit for declaratory judgment does not change the rule."

To the same effect is *International Hotel Co. v. Libbey* (7 Cir. 1946), 158 F. (2d) 717.

In *State Farm Mut. Automobile Ins. Co. v. Smith,* supra, cited by appellant, the decision, as in the *Greenough* case, turned upon the local law of Missouri and the court held, by analogy, that it should apply "the same principles which are applied by the Missouri courts in fixing the burden of proof in eminent domain proceedings." Under the California law, the burden of proof was on plaintiff. Furthermore, in the *State Farm* case the plaintiff was not asserting the affirmative of the issue or seeking affirmative relief, as was the appellant in this action.

In *Philip A. Hunt Co. v. Mallinckrodt Chemical Works,* (Ed. N.Y. 1947), 72 Fed. Supp. 865, cited by appellant, the court stated that the pleadings should be construed to ascertain which of the parties would suffer an adverse judgment if no evidence were received. In that case, the defendant counter-claimed, alleging patent infringement and sought affirmative relief by way of injunction and damages. Obviously, if no evidence were introduced, the court would have have had no basis upon which to issue the injunction or assess damages. Consequently, the court properly held that the burden was on defendant to prove the facts necessary to entitle it to relief. By parity of reasoning, the appellant in this case was obligated to

prove all facts necessary to entitle it to the judgment that it sought, and was obligated to prove the affirmative facts that it alleged.

The only other case cited by appellant is *Lumbermen's Mut. Casualty Co. v. McIver* (S.D. Cal. 1939), 27 Fed. Supp. 702, 110 F. (2d) 323. In the opinion by this court the provisions of Code of Civil Procedure, section 1981 were not mentioned, and the Court seemed to place considerable emphasis on the fact that the allegations of the complaint were affirmative in form—that the minor was driving the car rather than that the adult was not. Even under this holding, appellant would have had the burden of proving its affirmative allegations. And again, the appellant in the *McIver* case was not seeking affirmative relief as was the appellant in the instant suit.

In furtherance of its argument, appellant states that appellee "is the one possessed of complete facts and records as to its costs." (Appellant's Brief, p. 53.) If appellant seeks to imply that the facts and records were not available to it, such is not the case. In 1944 appellant reviewed appellee's figures at the plant. (R. 105, 109.) Appellant made a thorough audit of the cost records in 1946. (R. 413, 921-922.) After the commencement of this action, appellant was offered the opportunity of making a further audit by a certified public accountant, but it declined to go to the expense; it chose instead to indicate on blank forms the accounting information it desired and appellant furnished the information in the form requested. (R. 379-381; Pltf's. Ex. 18, R. 565-573.) Throughout the

trial, appellant from time to time requested other detailed information which, in every instance but one, was produced by appellee. (R. 855-856, 949, 967, 972-973, 1108, 1171-1172, 1245.) The only exception was the tabulation requested by appellant on December 24th which was not completed or produced prior to the termination of the trial because of the intervention of the holidays. (Appellant's Brief, p. 43.) At no time subsequent to December 24th did appellant ask for the tabulation. It is apparent from the foregoing that appellant had all the facts that it desired regarding appellee's cost of production and there is no basis for the suggestion that appellee alone was "possessed of complete facts and records."

In light of the allegations of the complaint and the authorities hereinbefore cited, we submit that to whatever extent the court considered that appellant had the burden of proof, its position was correct. This is particularly true in light of the fact that throughout the trial appellant assumed the burden as well as all advantages of the party having the affirmative of the issue, and did not give the court timely opportunity to rule on the point. Its contention on appeal is inconsistent with its conduct at the trial.

VI.

THE EVIDENCE SUSTAINS THE FINDING OF THE TRIAL COURT THAT A COMPOSITE SAMPLE OF EACH SHIPMENT OF GYPSUM AFFORDS A FAIR AND PROPER CRITERION OF THE GYPSUM DELIVERED, FOR THE PURPOSES OF PARAGRAPH (5) OF THE CONTRACT.

The contract does not contain any provision that obligates appellee to furnish appellant with samples of the gypsum shipped. It is entirely silent on the matter. Appellant's complaint did not allege the existence of any controversy on the subject. It was appellee's position below, as it is here, that there was no language upon which the court could make a declaratory judgment. (R. 214, 1306-1307.)

There was no evidence that the matter of sampling was ever discussed between the parties. Hence, there was no showing as to the intention of the parties in that regard. The testimony did show that gypsum is a bulk product, that it is fungible in nature, and is received and stored by appellant in quantities aggregating up to approximately 500 tons. (R. 387-388.) The evidence established also that a composite sample of the gypsum shipped affords a "fair criterion of the general quality of the output of the gypsum department." (R. 814.) On the basis of this testimony, the court found that a composite sample of the quantity of gypsum shipped by appellee to appellant in the course of a 24-hour period, affords a fair and proper criterion of the gypsum delivered and that such method of sampling is in accordance with the terms and provisions of the contract. (Finding 16, R. 57-58.) It is our position that if the subject was in issue or

within the purview of the contract, the evidence fully sustains the finding.

Appellant's argument on this point is to the general effect that for a number of years appellee furnished appellant with a sample of each car of gypsum delivered and that this operated as a practical construction of the contract. No authorities are cited and we know of no cases in which it has been held that a gratuitous service rendered by one contracting party to another, in connection with a matter that is not even mentioned in the contract, operates as a practical construction of the agreement to mean that the first party is obligated to continue the service. We fail to see how there can be practical construction of a provision which is nonexistent in a contract. As stated in 12 *Am. Jur.* 791:

> "Where a term of a contract is lacking, resort may not be had to the acts or conduct of the parties not in themselves amounting to an agreement for the purpose of supplying it."

We disagree with appellant that paragraph (5) of the contract permits appellant to reject any single carload that is not up to specification. We submit that a far more reasonable interpretation is the one made by the court that the conformity to specifications is to be determined on a per-shipment basis. Hence, if five cars are delivered in a day, it is entirely reasonable to determine the quality of the product by a composite sample representing the shipment. The evidence is uncontradicted that such a sample of this fungible goods affords a fair gauge of the quality. There is no evidence to the contrary.

CONCLUSION.

In *Grace Bros. Inc. v. Commissioner of Internal Revenue,* supra, this court stated that "the burden is upon him who attacks a finding to show that it is clearly wrong". Appellant has failed to sustain this burden in any particular. On the contrary, the reliable and substantial evidence preponderates in favor of the findings of the trial court, both as to the meaning of the contract and the determination of cost of production by appellee pursuant thereto. Consequently, and upon all of the other grounds hereinbefore stated, we respectfully submit that the judgment should be affirmed.

Dated, San Francisco, California,
April 25, 1949.

Respectfully submitted,
CLAUDE N. ROSENBERG,
TADINI BACIGALUPI,
KENNETH RAY,
Attorneys for Appellee.

BACIGALUPI, ELKUS & SALINGER,
Of Counsel.